

**LEGISLATIVE SERVICES AGENCY  
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**FISCAL IMPACT STATEMENT**

**LS 6241**

**BILL NUMBER: SB 77**

**NOTE PREPARED:** Nov 18, 2002

**BILL AMENDED:**

**SUBJECT:** Elimination of Inheritance Tax.

**FIRST AUTHOR:** Sen. Ford

**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** X GENERAL  
X DEDICATED  
FEDERAL

**IMPACT:** State & Local

**Summary of Legislation:** The bill provides that the state Inheritance Tax does not apply to property interest transfers from the estate of a person who dies after June 30, 2003. The bill also amends the Indiana Estate Tax formula and provides that the amended formula applies to the estate of a person who dies after June 30, 2003. The bill terminates the Inheritance Tax effective July 1, 2005, and makes conforming amendments.

**Effective Date:** July 1, 2003.

**Explanation of State Expenditures:** Under the bill, the state will no longer receive revenue from the Inheritance Tax beginning in FY 2005, but will experience a compensating increase in Estate Tax revenue in FY 2005 and FY 2006. In addition, the bill is expected to increase state General Fund expenditures on county Inheritance Tax replacement. The net state impact of the bill is summarized in the table below. (These estimates will be updated as new forecast totals and new tax data become available.)

Fiscal Year	Inheritance Tax Revenues	Estate Tax Revenues	State Expenditures for County Replacement	Net Increase (Decrease)
2005	(\$120.1 M)	\$13.4 M	(\$7.5 M)	(\$114.2 M)
2006	(120.1 M)	4.2 M	(7.5 M)	(123.4 M)
2007 and after	(120.1 M)	\$0	(7.5 M)	(127.6 M)

**Explanation of State Expenditures:** *Department of State Revenue:* Once the Inheritance Tax is repealed,

there could be a savings to the state from a reduction in staff in the Inheritance Tax Section of the Department of State Revenue. The October 2, 2002, state staffing table indicates that the Inheritance Tax Section has 16 full-time positions with an annual salary cost of \$398,000. Since staff members would still be needed to process returns, a specific savings due to staff reductions could not be estimated.

*County Inheritance Tax Replacement:* Elimination of the Inheritance Tax would increase expenditures from the state General Fund for county Inheritance Tax replacement by approximately \$7.5 M annually beginning in FY 2005. This is the maximum amount of replacement funding guaranteed to counties under the replacement procedure. (See *Explanation of Local Revenues*, below, for explanation of county revenue loss and replacement procedure.)

**Explanation of State Revenues:** The bill is expected to eliminate approximately \$120.1 M annually in Inheritance Tax revenue beginning in FY 2005. However, the reduction in Inheritance Tax liabilities is expected to increase Indiana Estate Tax revenue by \$13.4 M in FY 2005 and \$4.2 M in FY 2006. This offset from the Indiana Estate Tax is expected to decline to zero in FY 2007 as the phaseout of the federal state death tax credit (the Indiana Estate Tax base) is completed. The estimated net revenue loss from the bill is estimated to total \$106.7 M in FY 2005, \$115.9 M in FY 2006, and \$120.1 M beginning in FY 2007.

*Background on Inheritance Tax:* The bill would eliminate the Inheritance Tax applicable to transfers made by persons who die on or after July 1, 2003. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the full impact of the bill likely would not be experienced until FY 2005. The estimated impact of this change is based on the Revenue Technical Committee's FY 2003 forecast (updated November 14, 2001) for the Inheritance Tax totaling \$140.0 M. The forecast total is a combined amount including both Inheritance Tax and Estate Tax revenue. Based on a five-year (1988-2002) average, 85.8% of the revenue from both taxes is estimated to be attributable to the Inheritance Tax. This suggests that the Inheritance Tax will yield about \$120.1 M and the Estate Tax about \$19.9 M in FY 2003. These forecast totals are utilized as the base for the fiscal impact estimates.

*Background on Estate Tax:* The elimination of Inheritance Tax liabilities would affect Estate Tax revenues. Under current statute, Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal Estate Tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Under the bill, the Indiana Estate Tax would still be limited to estates paying federal Estate Tax, but the Indiana Estate Tax would be equal to the total state death tax credit. Consequently, for some estates the elimination of the Inheritance Tax would result in a compensating increase in the Indiana Estate Tax liability. The estimated impact of the bill on Estate Tax revenues is based on OFMA's Estate Tax database and the Revenue Technical Committee's FY 2003 forecast (updated November 14, 2001) for the Estate Tax totaling \$19.9 M. It is estimated that Estate Tax revenue would otherwise total \$2.2 M in FY 2005 and \$590,000 in FY 2006 after accounting for the phaseout of the federal state death tax credit (the Indiana Estate Tax base). The Estate Tax database consists of 559 estates of decedents who died between July 1, 1997, and June 30, 2000, and that paid Indiana Estate Tax. The Inheritance Tax changes provided for in the bill increased the Estate Tax liability of the sample by a factor of approximately 6.7 in FY 2005 and 7.5 in FY 2006. As a result, the Inheritance Tax changes are estimated to increase Estate Tax revenue by \$12.5 M in FY 2005 and \$3.8 M in FY 2006.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:** The repeal of the Inheritance Tax coupled with county Inheritance Tax

replacement is expected to result in an annual net revenue loss to the counties totaling \$2.9 M beginning in FY 2005. This net impact is summarized in the table below. (These estimates will be updated as new forecast totals and new tax data become available.)

	<b>Annual Impact Beginning in FY 2005</b>
Inheritance Tax Revenues (Local Share)	(\$10.4 M)
State Expenditures for County Replacement	7.5 M
Net Increase (Decrease)	(\$2.9 M)

Currently, counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. About 99.1% of Inheritance Tax revenue is derived from the resident Inheritance Tax. Based on the FY 2003 forecast for state Inheritance Tax revenue, annual county Inheritance Tax revenue is estimated to total about \$10.4 M beginning in FY 2003. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. The maximum amount of county replacement for any year is approximately \$7.5 M. A copy of a spreadsheet showing the amount of Inheritance Tax replacement guaranteed to each county under P.L. 254-1997 is available from the Office of Fiscal and Management Analysis.

**State Agencies Affected:** Department of State Revenue.

**Local Agencies Affected:** Counties.

**Information Sources:** *State Revenue Forecast*, November 14, 2001. OFMA Estate Tax database.

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